

Abstract: Under the NTS Reform (Non-Tradable Share Reform), this paper explores the cross-sectional relations between illiquidity and stock returns by considering the idiosyncratic volatility biases in the Chinese stock market. To this end, we propose a new illiquidity index that measures the liquidity of the Chinese stock market more precisely than indexes used in previous studies. Differing from prior studies, stock returns are decreasing in a stock's illiquidity both before and after the NTS Reform. Regarding the negative relation between illiquidity and stock returns, we find that stock returns show no clear relation with illiquidity after controlling for idiosyncratic volatility biases. Furthermore, we use residual approach to eliminate the effect of idiosyncratic volatility, and find there exists a positive relation between illiquidity and stock returns after the NTS Reform.